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SENSITIVE  
SIPDIS

STATE FOR EEB AND EAP/J  
NSC FOR DANNY RUSSELL AND JIM LOI  
USTR FOR WENDY CUTLER AND MICHAEL BEEMAN  
TREASURY FOR ROBERT DOHNER

E.O. 12958: N/A  
TAGS: [ECON](#) [EFIN](#) [PREL](#) [JA](#)  
SUBJECT: NIKKEI BREAKS 10,000 SUGGESTING THE ECONOMY HAS  
HIT BOTTOM -- THE JURY REMAINS OUT

11. (SBU) Summary: A spate of relatively positive economic news, both international and domestic, pushed the Nikkei 225 to close over the psychologically important 10,000 level on June 12. Some politicians and pundits argue the economy has "hit bottom" and will recover, albeit slowly, over the next few quarters. However, while there is broad-based agreement Japan's economy is no longer in a steep decline, there are still questions on whether the economy will stage a sustainable recovery starting in the second half of 2009. Tokyo-based analysts are concerned the economy may dip again in 2010 as the effects of PM Aso's stimulus measures run out and consumers tighten their spending due to uncertain employment prospects and falling wages. Many in Japan continue to look to exports, especially to China and the U.S., as the way out of the downturn rather than taking measures needed to restore the economy to health. The country's on-going political difficulties further mitigate against needed structural changes. Nevertheless, Japan's economy is likely to expand slightly in the April-June quarter if only because of the immediate impact of the GOJ's fiscal stimulus measures. End Summary.

#### Some Good Economic News Pushes Nikkei and Confidence Up

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12. (SBU) Recent economic data show Japan's economy is stabilizing somewhat following dramatic contractions in exports, manufacturing and overall GDP since October 2008. The Bank of Japan upgraded its economic assessment of the economy last month from "economic conditions are deteriorating" to "the pace of the worsening of economic conditions is easing" in its monthly economic view. The BOJ is expected to note further improvements in its June report. Analysts caution, however, the BOJ is still concerned about weak domestic demand and consumer price deflation, even if declines in manufacturing and exports are easing.

13. (SBU) The composite index (CI), Japan's key gauge of the current state of the economy is strengthening. The CI rose for the first time in 11 months in April as industrial production, overtime work hours, and retail sales improved one point over March to 85.8 (Base Year 2005 equals 100). The Nikkei 225 index, partially as a result of these Japanese data and partially in response to signs of recovery in the U.S. and China, closed around the psychologically important 10,000 level June 12, a level not seen since August 2008. The broader TOPIX index, which provides a more comprehensive view of the market, has also climbed steadily since March and is approaching the 1,000 level. Factory output numbers, which jumped 5.2 percent in April month-on-month, helped rebuild investor confidence. Nevertheless, analysts again

caution the jump may not yet be sustainable due to weak corporate profits and deflation.

#### But, The Real Story is Not Confidence Inspiring

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¶4. (SBU) The up-tick in indices of consumer confidence comes against the backdrop of a stabilizing world economy and the impact of Japan's four fiscal stimulus measures and suggest the private sector has begun to believe Japan's economic free-fall has come to an end. However, the government sector is the only component of the economy that is expanding and bankruptcies, unemployment, and weak external demand for Japanese finished goods continue to cloud prospects for a sustainable economic recovery. There were 1057 new bankruptcy filings in May, an increase of 6.3 percent from April, and unemployment topped 5 percent for the first time in half a decade. A more disturbing statistic on the labor front is the 500 percent increase in companies applying for worker adjustment assistance since January 2009. 46,558 companies requested GOJ financial assistance in April 2009 to support the furloughing of 2.3 million workers. Japanese exports remain weak and the prospects for recovery, based on a 20.5 percent decline in industrial electricity demand year-on-year in May, are uncertain.

¶5. (SBU) Against this backdrop, Japan's Council on Economic and Fiscal Policy announced June 10 its latest effort to reduce gross Japanese government debt, which stands at more than 170 percent of GDP. The plan involves increasing the value added tax one percentage point a year every year beginning in 2010 until 2017, to 12 percent. For the plan to succeed, however, the Japanese economy would have to expand

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an average of 2 percent annually, a growth rate last seen in the late 1980s. The Nikkei criticized the plan in a June 10 op-ed because it includes no structural or regulatory reforms the editorial board believes are essential if the Japanese economy is to expand that quickly. The government in its recently released the 2009 Draft Policy Guidelines on Economic and Fiscal Policy (the annual "Honebuto" report) set a target for halving the government budget deficit by 2014. As recently as 2006, the government set the goal of achieving "primary fiscal balance" -- a balance of the government's current account, excluding long-term capital expenditures -- by FY-2011. That goal is now pushed back to a vague "within 10 years." The government also said it hoped to "stabilize the national debt as a percentage of GDP - now 170 percent and climbing -- by "the mid-2010s" and begin to reduce Japan's debt-to-GDP ratio starting in FY-2020.

#### LDP Versus DPJ on Japan's Economic Model

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¶6. (SBU) Prime Minister Aso is being given some credit for helping to stabilize the economy through the size of his April fiscal stimulus program. Critics, however, still argue it is narrowly focused on short-term stimulus to buoy the electorate in the run-up to the coming Lower House elections.

It falls short of the reforms analysts have long said Japan needs to undertake. Japan's rapidly greying population plus the need to increase stagnant incomes and to improve the quality of work and life for low-income workers are seen as only making the task tougher. The opposition Democratic Party of Japan's election manifesto recommends some changes to assist farmers, workers and families, but the economic direction of the party is still unclear; especially given its statements about helping Japan's farmers and also revising Japanese postal reform. Furthermore, the DPJ has yet to articulate how it will pay for these programs.

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